No. 11,064

In the United States Circuit Court of Appeals

For the Ninth Circuit

Commissioner of Internal Revenue, Petitioner

vs.

Madeleine N. Sharp, Respondent

On petition for review of the decision of The Tax Court of the United States

Brief for the Respondent

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OPINION BELOW

The opinion of the Tax Court of the United States (R. 29-38) may be found in 3 T. C. 1062.

JURISDICTION

The petition for review involves a deficiency of $750 in gift taxes for the year 1938. The taxpayer filed her gift tax return for the year 1938 with the Collector of Internal Revenue for the Second Collection District of New York. (R. 41.) On January 12, 1942, the Commissioner mailed a statutory notice of deficiency to the taxpayer. (R. 6-9.) On April 6, 1942, the taxpayer filed a petition with the Tax Court for redetermination of her gift tax liability, pursuant to Section 1012 of the Internal Revenue Code.

(R. 3-5.) The final order and decision of the Tax Court, deciding that there was no deficiency in gift tax was entered on August 22, 1942. (R. 39.) It has been stipulated (R. 40) by the parties that the decision of the Tax Court may be reviewed by the Circuit Court of Appeals for the Ninth Circuit and the petition for review was filed November 9, 1944 (R. 41-45), pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether a gift in trust for the taxpayer's minor son was a gift of "future interests in property" and hence not within the $5,000 exclusion provision of Section 504 (b) of the Revenue Act of 1932.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 502. COMPUTATION OF TAX.
>
> The tax for each calendar year shall be an amount equal to the excess of—
>
> (1) a tax, computed in accordance with the Rate Schedule hereinafter set forth, on the aggregate sum of the net gifts for such calendar years, over
>
> (2) a tax, computed in accordance with the Rate Schedule, on the aggregate sum of the net gifts for each of the preceding calendar years.
>
> *　　*　　*　　*　　*
>
> SEC. 504. NET GIFTS.
>
> (a) *General Definition.*—The term "net gifts" means the total amount of gifts made during the calendar year, less the deductions provided in section 505.

(b) *Gifts Less Than $5,000.*—In the case of gifts (other than of future interests in property) made to any person by the donor during the calendar year, the first $5,000 of such gifts to such person shall not, for the purposes of subsection (a), be included in the total amount of gifts made during such year.

Treasury Regulations 79 (1936 ed.):

ART. 11. *Future Interests in Property.*—No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the calendar year. "Future interests" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time.***

STATEMENT

The respondent adopts the statement of facts set forth in petitioner's brief, pages 3 to 5, inclusive. For purposes of convenience Article First of the trust instrument involved is set forth herein in full:

Article First: A. To hold, manage, invest, and reinvest said trust estate, and to collect and receive the rents, interest, income and dividends (hereinafter referred to as income) therefrom and after paying the proper charges against the same, to apply and pay over to the use and for the benefit of my son Donald Nichols Sharp the net income therefrom during his minority, and upon his reaching his majority to pay the net income to my said son Donald Nichols Sharp during his life. The Trustee may make any payment of any income thus applicable

> to the use of my son Donald Nichols Sharp, during his minority, by paying the same to his mother, or guardian of his property, or other person or corporation designated by the Donor (without obligation to look to the proper application thereof by the person receiving it) or by expending it in such manner as the Turstee, in its discretion, believes will benefit my son. Any balance of income shall be accumulated until the arrival of my son, Donald Nichols Sharp at majority, at which time the Trustee shall pay over the said accumulated income to my son Donald Nichols Sharp.

SUMMARY OF ARGUMENT

The issue in this case turns upon a construction of the trust instrument. A reasonable construction of the trust instrument requires the conclusion that the interest of the donee beneficiary in the income of the trust was not limited to commence in use, possession or enjoyment at some future time. The donee beneficiary was entitled at all times to demand and possess the income of the trust and the trustee was under the express duty to apply and pay over the net income of the trust to the use and for the benefit of the donee. Since the interest of the donee was a present interest in the income of the trust the taxpayer is entitled to the exclusion claimed. The decision of the Tax Court is correct and should be affirmed.

ARGUMENT

The gift of the income of the trust for the benefit of a minor beneficiary was a gift of a present interest as to which the taxpayer was entitled to an exclusion allowable in computing taxpayer's gift tax for the year 1938.

The issue in this case turns upon an interpretation of the trust instrument. The question to be determined is whether the donor's minor son has a present interest in the trust income. The Supreme Court in *Fondren* v. *Commissioner,* 324 U. S. 18, 65 S. Ct. 499, 89 L. Ed. 449, has recently outlined some guiding principles to be applied in determining whether a gift is of a present or future interest. *Commissioner* v. *Disston* (Sup. Ct.) decided June 4, 1945, 89 L. Ed. 1202, C. C. H. Inheritance, Estate and Gift Tax Service, Paragraph 10,207, Prentice Hall Federal Tax Service, Paragraph 72,026. To be classed as a present interest, the donee must have the right presently to use, possess or enjoy and there must be no barrier of a substantial period of time imposed by the trust instrument between the will of the donee to enjoy what has been given him and that enjoyment. The same concept is implicit in Treasury Regulations 79, Article 11, *supra,* which defines future interest as follows:

> "Future interests" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time.

If the donee of the gift has the right presently to use, possess or enjoy the subject of the gift, the gift is not a future interest within the meaning of Treasury Regulations 79, Article 11, *supra,* or of the term "future interests" as used in Section 504 (b) of the Revenue Act of 1932, *supra.*

Applying these principles to the instant gift the question presented is did Donald Sharp, the donee of the income of the trust, have the right to use, possess or enjoy the income of the trust from its inception? As noted above, the question turns upon an interpretation of the trust instrument. The Tax Court (R. 36) has interpreted the trust instrument to confer upon Donald Sharp a present absolute right to the income. The interpretation of the Tax Court is clearly correct. "Article First" of the trust instrument (R. 12) contains a clear and unequivocal direction to the trustee " * * * to apply and pay over to the use and for the benefit of my son Donald Nichols Sharp the net income therefrom during his minority, and upon his reaching his majority to pay the net income to said son Donald Nichols Sharp during his life." No discretion is given to the trustee. No contingencies or conditions are provided for. No standard is established from which it may be inferred that the need of the beneficiary limits his right to the income. The trustee is directed flatly to apply and pay over to the use and for the benefit of the donee the net income during his minority. Where a trust instrument directs the income to be applied to the use of the beneficiary, no discretion being given to the trustee to apply only so much of the income as it might deem necessary for maintenance, the beneficiary is entitled to have the entire income paid over as it accrues. *Gasquet* v. *Pollock,* 37 N. Y. S. 357, 1 App. Div. 512, aff'd. 158 N. Y. 734, 53 N. E. 1125. It is clear that the above language of the trust instrument did not give the trustee any authority to accumulate income or any discretion to withhold income from the beneficiary for

any reason. Petitioner concedes in his Opening Brief (p. 8) "If that were all, it might well be that a present interest was created."

"Article First" of the trust instrument goes on to provide (R. 13) "The trustee may make any payment of any income thus applicable to the use of my son Donald Nichols Sharp, during his minority, by paying the same to his mother, or guardian of his property, or other person or corporation designated by the Donor (without obligation to look to the proper application thereof by the person receiving it) or by expending it in such manner as the Trustee, in its discretion, believes will benefit my son." This additional language of "Article First" (R. 13) in no way limits the absolute direction contained in the first sentence of "Article First" (R. 12) to apply and pay over the net income to the use and for the benefit of the donee. As pointed out by petitioner in his Opening Brief (p. 8), a cardinal rule of construction of a trust instrument is that the intention of the settlor as evidenced by the language of the instrument must prevail and that intent must be collected from the whole instrument taken together. Applying this rule to the instant trust instrument it is apparent that the second sentence of "Article First" (R. 13) is not a limitation upon the outright direction to apply and pay over the net income contained in the first sentence but is rather an implementation of that direction and is designed to protect the trustee in paying out income to a minor and to afford a workable method of handling the minor's funds. The trustee may pay the net income during minority to the donee's mother or guardian or other person or corpora-

tion designated by the donor *without obligation to look to the proper application thereof by the person receiving it* or the trustee may expend the net income in such manner as the trustee in his discretion believes will benefit the donee. This language is not designed to impose upon the trustee the duty of administering the donee's expenditure of funds but is designed to relieve the trustee of any duty in this regard and to make it possible for the trustee to carry out the mandate of the first sentence of "Article First" (R. 12) to apply and pay over the net income to the use and for the benefit of the donee without assuming the responsibility of ascertaining the use to which the funds are put. Thus interpreted, the first and second sentences of "Article First" (R. 12, 13) are consistent and each is given meaning. If the language of the second sentence is construed as a limitation on the absolute direction contained in the first sentence, the first sentence becomes meaningless. The first sentence of "Article First" (R. 12) contains the direction to pay the funds to the donee which creates an absolute right in the donee to presently demand, receive and possess the net income. The second sentence implements the first sentence by setting up the procedure for carrying out the direction and relieves the trustee of any duty to supervise the expenditure of funds by the donee or of seeking the appointment of a guardian of the donee or of paying the funds into court. Where the beneficiary of a trust who is entitled to the benefit of the income is an infant or otherwise under a legal incapacity, and the trust instrument makes no other provision, it is ordinarily the duty of the trustee to pay the income to his guardian or to pay it into court. *Gasquet*

v. *Pollock, supra; Matter of Taylor*, 234 App. Div. 892, 254 N. Y. S. 505, aff'd. 260 N. Y. 527, 184 N. E. 78. The second sentence of "Article First" (R. 13) is designed to give the trustee freedom in carrying out the absolute direction contained in the first sentence rather than to limit the duty to pay over.

The last sentence of "Article First" (R. 13) provides: "Any balance of income shall be accumulated until the arrival of my son Donald Nichols Sharp at majority, at which time the Trustee shall pay over the said accumulated income to my son Donald Nichols Sharp." The language of the last sentence is not a limitation upon the absolute direction to apply and pay over the net income to the use and for the benefit of the donee. It confers no discretionary power on the trustee to withhold income and to accumulate it. The last sentence of "Article First" (R. 13) with reference to the accumulation of "any balance of income" in no way limits the absolute right of the donee to possess income or the absolute duty of the trustee to apply and pay over income contained in the first sentence. Since the donee has the absolute right to possess income, his interest is not a future interest with the definition of "future interests" contained in Treasury Regulations 79, Article 11, *supra*. The provision for the accumulation of income is designed and intended to meet the contingency that the beneficiary may not exercise his right to possess all of the income and to put at rest any question as to the ultimate disposition of such income which the donee may not withdraw. See *In Re Kirby's Estate*, 231 N. Y. S. 408, 133 Misc. 152, appeal denied 239 N. Y. S. 390, 228 App. Div.

171. The fact that the beneficiary may not exercise his absolute right to possess all of the income and in this event the trustee is directed to accumulate such income does not change the beneficiary's absolute right to possess the income into a future interest or extinguish his absolute right to possess the income. Moreover, the trustee's duty to accumulate arises only if there is "any balance of income" which clearly means income which has not been applied or paid over as directed in the first sentence of "Article First" (R. 12). Since the first sentence clearly gives the trustee no discretion in the matter of the payment of income but places an absolute duty on the trustee to pay over the income and creates an absolute right in the donee to possess the income, it is equally clear that the trustee derives no added power or discretion from the last sentence directing the accumulation of "any balance of income" which the donee may allow to remain.

Furthermore, there is no direction contained in the trust instrument to segregate income into current and accumulated income. Accumulated income and current income are therefore equally subject to the right of the beneficiary during minority. During minority the donee's right would have to be exercised through his parent or guardian. After reaching majority he may personally enforce his right. However, Congress did not intend to penalize gifts to minors merely because the legal disability of their years precludes them for a time from receiving their income in hand currently or from directly exercising their legal rights. *Fondren* v. *Commissioner, supra.* Reasonably construed "Article First" (R. 12, 13) of the trust instrument gives no power

or discretion to the trustee to withhold or accumulate income. On the contrary, the trustee is expressly directed to apply and pay over the net income for the use and benefit of the donee. The trustee is directed to accumulate income only in the event that there remains "any balance of income" which the donee may not have withdrawn. This direction is merely a precautionary measure designed to put at rest any question as to who would be entitled to such income.

The language of the Supreme Court in *Commissioner* v. *Disston, supra,* referred to in petitioner's brief (pp. 12, 13), "But, even though the trustees were under a duty to apply the income for support, irrespective of outside sources of revenue, there is always the question of how much, if any, of the income can actually be applied for the permitted purposes" has no application to the instant case. The trust instrument in the Disston case directed the accumulation of income during minority and allowed the payment of income during minority only for certain limited purposes. The donee's right to income was conditioned upon a showing of need for the limited purposes. In the instant case there is no limitation upon the direction to apply and pay over the income to the use and for the benefit of the donee. The income could be used by the donee for any purpose and therefore a showing of need for a particular purpose is not required. The above language of the Supreme Court in the Disston case must be read in the light of the facts in that case which clearly showed that income was to be accumulated and paid out only for limited purposes. If the above language of the Disston case is to be applied in fact situations where the beneficiary of the income of a trust

has an absolute and unqualified right to the income, every gift of trust income will be a future interest unless the donee can show need for the income. Certainly the Supreme Court never intended such result but intended the language to apply to the particular facts before it in the Disston case.

The language of the Supreme Court in the Disston case with reference to the necessity of evidence indicating a steady flow of some ascertainable portion of income to the minor, referred to in petitioner's brief (p. 10), has no application to the instant case. As noted above, the trust instrument in the Disston case directed the accumulation of income and provided for payments to the beneficiaries for limited purposes only. In the instant case the trust instrument directs the payment of income by the trustee to the donee, without limitation as to purpose, and provides only for the accumulation of amounts which the donee as a matter of grace allows to remain. The trust instrument in the instant case itself provides the necessary indication that a steady flow of income to the minor is required by the terms of the trust. Since there is no condition, standard or need which must be satisfied or proved before the right of the beneficiary accrues, no evidence of need or use of income is required. A reasonable construction of the trust instrument giving effect to all of its provisions requires the conclusion that the interest of the donee of the income of the trust was not limited to commence in use, possession or enjoyment at some future time. The dominant purpose of the settlor, as gathered from the whole instrument, repels the idea of postponement. *Smith* v. *Commissioner,* 131 F(2) 254 (C. C. A. 8th).

The petitioner in his brief (p. 13) has referred to the legislative history of the section of the revenue laws in question in subsequent revenue acts and has pointed out that Congress has reduced the amount of the exclusion. We fail to see the relevancy of Congressional action taken subsequent to the enactment of the revenue act in question unless petitioner seeks to impute to Congress the intent to retroactively reduce the amount of the exclusion which Congress clearly did not do.

A reasonable construction of the trust instrument provides no basis for petitioner's contention contained in his brief (p. 13) that the trust instrument contains conflicting directions to the trustee. The trust instrument contains an absolute direction to apply and to pay over the net income to the use and benefit of the donee with express provisions for carrying out that mandate which are neither conflicting nor ambiguous.

CONCLUSION

The decision of the Tax Court is correct in holding that the taxpayer is entitled to the exclusion claimed. Its decision should be affirmed.

Respectfully submitted,

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